THE SCOTTISH ECONOMY AT MID-TERM - MORE THAN AN INVISIBLE HAND AT WORK.

Lionel Barber
The Scotsman

One of the most vivid pieces of propaganda against Conservative economic policy appeared on the streets in August 1980. Blazoned across the front page of the mass circulation Daily Record were the words: "WANTED: prime minister urgently required to take over from failed incumbent. Must care about people, find jobs for two million (241,267 in Scotland). Salary £30,430." The mock advertisement summed up the anger and anguish many Scots felt about the massive jump in unemployment since the Conservatives assumed office. Squeezing public spending and exposing manufacturing industry to the full blast of a world recession was bound to drive up the number of unemployed in Scotland, well familiar with being last with the boom and first with the slump.

Scotland had little to expect from a Conservative government. She showed herself reluctant to tread the path of self-government in March 1979 and two months later in the General Election she placed her faith in a strong Labour majority at Westminster. The story of the next two years is therefore of a Tory-led Scottish Office wielding power without the authority bestowed by a Scottish majority in the House of Commons, a team professedly unionist and anti-interventionist which showed little sign of persuading Scots that unemployment was the inevitable result of hard-headed policies needed to conquer inflation.

That,however, is only half the story. For behind this tough, sometimes abrasive facade, Scottish Office ministers discovered their own invisible hand to pull the levers of the economy. It may not have been what Adam Smith or Milton Friedman had imagined, but as a form of "constructive interventionism" it helped them to pull

off some notable victories and stave off what seemed at first like probable defeats. The approach was most visible during the takeover battle for the Royal Bank of Scotland Group, an issue rightly recognised as one of crucial importance for the Scottish economy, though the outcome had still to be resolved at the time of writing.

The arrival of Mrs Thatcher at No 10 Downing Street marked a radical departure in political and economic thinking. Underlying her preoccupation with monetary targets and small-shop-on-the-corner talk of "not spending money you have not earned" was a deep scepticism about the power of governments to change or improve things in a democracy. Government was neither omniscient nor omnipotent and there was a limit to what the people should expect of their rulers. The burden was placed on the people themselves: the task of the UK workforce was to cut their expectations, the challenge to improve productivity.

In Scotland Conservative economic policy differed in style and philosophy from that of their predecessors. In speech after speech ministers spelt out the same message: Scotland was part of the UK economy which was undergoing a structural change and it was not the Government's job to hinder that process by ineffective intervention which would only act as a palliative and would cost public money.

When the going began to get rough and unemployment began to soar, the tune barely changed. Indeed so anxious were ministers to get the message across that two identical speeches were given within the space of a few days by Messrs. Fletcher and Younger to public and private sector leaders. It was, as The Scotsman observed, a case of "The speech now going on all platforms." The change in style was the natural result of the change in philosophy. Mr Younger steered clear of meetings with trade unions, management, local councillors and local MPs which Labour used to see as a necessary show of sympathy at such times. After each big closure the Scottish Office press office would send a short expression of regret coupled with the explanation that it was a "commercial decision."

There were obvious pitfalls in such an approach. At worst it could be attacked as a sign of insensitivity and lack of concern towards those suffering the distress of losing their jobs; at best it could be seen as a rather lame excuse for inaction. Sooner or later questions were going to be asked about what George Younger and Alex Fletcher were doing to fight Scotland's corner at Whitehall. If the answers were unsatisfactory then both Labour and the SNP would have plenty of ammunition in store for the next General Election.

The Government's natural supporters in Scotland were not slow to remind them of this. Mr Robin Duthie, Mr Fletcher's choice for the vacant post of chairman of the Scottish Development Agency, ruffled plenty of feathers when he accused Londoners of not knowing what was happening north of Watford. He said people in the South East of England had no idea how serious the problem of unemployment was in places like the West of Scotland. And, making a point perilously close to heresy, he said he doubted the wisdom of closing down capacity at the cost of so many jobs.

For George Younger and Alex Fletcher the difficulty lay not only in having to bend the ears of instinctive anti-interventionists such as Sir Keith Joseph. They were also well aware that their own parish was, at least initially, more vulnerable than most to the effects of a recession and strict monetary policies which cut the amount of money for regional aid. The sheer size of the labour-intensive manufacturing sector in Scotland meant that a labour shake-out would have a horrific impact on the number of people out of work.

The problem was compounded by the traditional reliance on overseas manufacturing companies for providing jobs. In 1980 one estimate put the number of jobs at 100,000 jobs or 16 per cent of the workforce. During a slump foreign companies have a habit of retrenching abroad before slimming down at home and this was exactly what happened in Scotland in the first two years of Conservative rule. When Singer closed down their plant at Clydebank 4500 jobs went at a stroke. The list of foreign or foreign-owned companies shutting down seemed endless: Monsanto in Ayrshire, Pye TMC at Livingston, Wiggins Teape at Corpach, VF Corporation at Greenock, Massey Ferguson at Kilmarnock. The worrying thing was the number of jobs lost; these were not small factories, they employed hundreds of people.

There were question marks too about Scotland's dependence on foreign investment. In the Seventies American companies shed 40,000 jobs and the number of incoming companies providing labour nowhere

nearly matched that number. The redundancies and factory closures seemed to be a brutal testimony to the way Scotland had become a branch factory economy with little or no control over her own future. As Ray Perman of the Financial Times put it: "One of the dangers now facing Scotland is that the new industries coming to replace the old will be in the same position in 10 or 20 years time and today's bright hopes on the frontiers of technology will be tomorrow's peripheral plants with high overheads to be closed when world capacity has to be cut back."(1) Such thoughts did not prevent the Government from launching a big drive to bring more inward investment to Scotland. Nor did it prevent one of the fiercest battles being fought with the Scottish Development Agency over control of this function, though the controversy was also used as an excuse for bringing the SDA, a Labour creation, under a tighter rein.

After the failure to attract the US electronics company Mostek, a report by a group of management consultants highlighted Scotland's fragmented industrial promotion effort. Though it was prepared for the SDA, it had the effect of galvanising Mr Fletcher, never a great believer in the Agency's promotion role abroad, which he felt was too much like a haggis and bagpipes brigade. Fletcher's line was that the Foreign Office consular staff were well equipped to deal with industrial promotion and there was no sense in duplicating the role. Once again Robin Duthie failed to see eye to eye with his former sponsor. Scotland, he said was an entirely separate entity and had to be marketed as such. Duthie further blotted his copy book by publicising his victory in keeping open the overseas offices of the SDA when he gave evidence to the Scottish Select Committee on that same subject.

The result was a messy compromise. Firstly, the Select Committee split on party lines on the question of the overseas role of the SDA. The Conservatives said they should pull out and should close their offices in the United States and Europe; Labour responded by producing a minority report defending the SDA. A more united approach might have been possible had it not been for another outspoken outburst from Duthie who likened monetarism to a "blunt instrument." That scuppered any chances of a joint approach and made the Tories even more disaffected with Duthie. In fact, Fletcher had decided to go his own way before the final report was published and in March this year he announced that he intended to set up a "Locate in Scotland" investment bureau. This was the "one door" approach to inward investment which merged the responsible departments in the SDA and the Scottish Economic Planning Department. It marked a victory for the Civil Service.

The new team was to be led by Dick Burns, a senior civil servant and he made his presence felt when the Japanese car giant Nissan indicated they were looking to set up a car plant in the UK. Local authority planners were invited to a meeting in Glasgow for what they thought would be a discussion on how best to present their individual cases. It turned out to be a diktat - Dick Burns and his men had already decided on four sites to offer the Japanese. The notion of bringing a car plant to Scotland in the wake of the Linwood closure was a non-starter, but the occasion provided a useful guide to the way the SDA were being elbowed out and how the Civil Service intended to take control.

But the Conservatives' relationship with the SDA grew a little better with time. After the initial boardroom bloodletting, the dismissal of Sir William Gray, then chairman, and the resignation of Lewis Robertson, chief executive, the Agency had an easier ride than its counterpart in the South, the National Enterprise Board. True, its budget was trimmed from £700 million to £500 million and its investment wings were clipped in December 1979. The new guidelines stated that loans or shares over £1 million had to be referred to the Secretary of State for approval, but that was hardly a bold move since the limit under Labour was only £2 million.

Fletcher saw a different role for the SDA. If it had been a virility symbol for "regeneration" under Labour, the Tories wanted a blend of joint ventures with financial institutions and private capital. Fletcher's specific idea was to set up a new investment bank, but the Scottish clearers were far from enthusiastic. Plan B was that they should participate in a new holding company for Agency investment but again private money was slow to appear. The role of the SDA in the rescue of the Weir Group, Scotland's largest engineering group, was a more successful story and it highlighted the constructive interventionism alluded to earlier. Weir is based only a short distance from the Linwood car plant and if

it had gone under the storm may well have lasted until the next election. In many ways Weir was Scotland's ICL, the main difference being that it did not need a newspaper campaign to point out that there was little sense in allowing a good company with good products to go to the wall in the name of free market economics.

The group began to skid out of control early in 1980 when the core of its business, the pumps side, fell wildly behind budget. Within a few months the company was forced to shed 1000 employees and was reporting huge losses. More seriously, the chairman, Lord Weir, had expressed confidence in his annual statement only months earlier that there would be a recovery sometime in 1980. By September 1980 the group was forced to put together temporary bridging arrangements with its banks and the Finance Corporation for Industry, which had made a loan of £11 million some years earlier. It was clear to Alex Fletcher, who had been warned earlier in the year that the group was in deep trouble, that survival would depend on the banks' willingness to defer payment on some of their debt.

The solution was for Weir's overdraft to be converted into new preference shares and the signs are that Fletcher, aided by the new chief executive of the Scottish Development Agency George Matthewson, twisted a few arms in banking circles to ensure that they did not pull the plug on the business by insisting on repayment. Scottish institutions were less keen on becoming drawn into the Weir deal when it came to the floating of the preference shares; the new chairman Sir Francis Tombs (part of the deal was that Lord Weir would step down) said he was disappointed that there had been a lack of enthusiasm for the shares. In fact they were snapped up weeks later by an American private investor Derald Ruttenberg. Despite the success of the rescue, there was a feeling that Scots may have missed out on an opportunity to show their commitment to an important company still based in Scotland.

Another important company to benefit from the backroom manoeuvering of Scottish Office ministers was Ferranti. Ferranti employ well over 7000 workers in 10 Scottish plants in high technology and precision engineering, exactly the activities which were identified by the Conservatives as the key to Scotland's economic future. Its contribution to the group's total turnover in 1979 was 40 per cent; no mean achievement. When Ferranti ran into trouble in the mid Seventies Labour called in the National Enterprise Board and asked them to take up a 50 per cent holding in the group. Under the new Tory regime private capital was supposed to do the job and so Sir Keith Joseph ordered the sale of the NEB holding, the argument being that Ferranti no longer needed NEB crutches and should be prepared to stand on its own two feet.

Sir Keith's move badly miscalculated the initial effect it would have on public opinion in Scotland where people were less impressed with "sale of the century" rhetoric. They feared that sale of a majority shareholding would leave Ferranti vulnerable to a takeover. The giant electronics firms GEC and Racal were prime predators. A takeover could mean that the parent company would seek to rationalise in Scotland where business was duplicated. At the very least, as Peter Balfour, chairman of the Scottish Council, argued, there was room for concern about the possible effect on future growth of Ferranti's manufacturing plants north of the Border. Alex Fletcher's invisible hand went to work. He knew he could use the Labour Party and the Scottish TUC as an "advance guard" to stake out a position calling for no sale of shares; he also knew he could block the sale of a controlling stake provided he could come up with a compromise solution which would open up the shareholding while protecting Ferranti's independence.

After several weeks of intensive lobbying at Westminster and wooing the financial institutions in Edinburgh, Fletcher was able to argue that Scots would not stand for a takeover by either of the two electronic giants. He also had the support of George Younger who argued that the interests of the company (who were against a takeover)had to be considered as well as the interests of the taxpayer (whose NEB stake had risen substantially in value). Having bent Sir Keith's ear,Fletcher was able to come up with his compromise solution: the NEB should place their 50 per cent holding with financial institutions rather than to the highest bidder on the open market and the institutions should not be allowed to sell their holding for two years without the permission of the NEB. This was the "covenant solution" and Sir Keith reluctantly agreed to it.

The significance of the Ferranti battle was that it showed that the Scottish Office were not prepared to let a good company

fall into the hands of a competitor in deference to the free play of the market. When it came to the crunch Fletcher and his colleagues were unwilling to trust the market or the Monopolies Commission to safeguard the interests of Ferranti; they were even prepared to set a dangerous precedent by nominally restricting investment managers' freedom to sell shares when they wished - hardly the behaviour one would normally associate with Conservative rhetoric.

The response from Scottish institutions was disappointing. They took a dim view of the 530p price tag and it was later reported that they had taken only 20 per cent of the 50 per cent NEB stake. This pulled the carpet from under Fletcher's argument that the institutions were queuing up to get their hands on shares. He later said the delay in making a move on the market was an example of "Scottish canniness" or a desire to pick them up at the best price. He failed to mention that he had to jolly some of them along to do just that. Sir Arthur Knight, then chairman of the NEB, said the institutions had not been as enthusiastic as expected given the strong political campaign in Scotland. That may have been a tacit admission that Fletcher had succeeded with a hand which was not half as strong as it had first appeared to be.

Ferranti were not the only company threatened by predators outside Scotland. The publishing house Collins successfully fought off a bid by Rupert Murdoch's News International after a bitter struggle. Also in Glasgow an even bloodier boardroom battle was fought out between Mr Tiny Rowland of Lonrho and House of Fraser the department store group. Sir Hugh Fraser, then chairman, spent months slinging mud at Mr Rowland until they met secretly in an Ayrshire hotel and were suddenly the best of friends again. The Fraser board were not impressed; Sir Hugh was ousted as chairman and the bid went to the Monopolies Commission. It was not the first time the Commission were called in to examine whether a sound Scottish company should merge with or be submerged by an ambitious suitor with plenty of money in his wallet.

Two companies eager for a match who had more money than most were the Hong Kong and Shanghai Banking Corporation, and the Standard Chartered Bank. Their bids for the Royal Bank of Scotland Group, which contained the largest and only wholly independent bank in Scotland, illustrated more than anything else how difficult it was to retain a strong indigenous base in the Scottish economy. For Alex Fletcher the proposed takeover was crucial. Fletcher consistently argued that he was in favour of Scots managing their own businesses. He was well aware of the role that banks could play in "fixing" or smoothing out hiccups in companies like the Weir Group, he knew the importance of banks in lending venture capital for small ambitious companies, the very sort he and other Tories had sought to promote since coming to power. One of his favourite equations for the rejuvenation of the Scottish economy was electronics plus oil plus banks equals future success.

Fletcher was reportedly horrified when he opened his copy of the Financial Times and read that the Royal Bank of Scotland were holding merger talks with Standard Chartered, a UK registered bank with considerable interests in the Middle East and South Africa, but no foothold in the UK market. He was also distinctly unimpressed with the price on offer - a little over £300 million pounds plus eight directors on the Standard Chartered Board. The scene was set for the reactivation of the Scottish lobby which had worked so effectively during the Ferranti battle. Fletcher made some informal contacts with members of the Scottish financial institutions and found that they too felt strongly about the Royal Bank diving into bed with another bank, particularly one which was likely to remove control to London. And so a lobby was born. Peter de Vink, aided and abetted by Ian Noble, both successful financiers, began to enlist support in Edinburgh and Glasgow for a campaign to block the merger. Meanwhile the invisible hand went to work at Westminster.

Fletcher approached Scottish Tory backbenchers and asked them for their views. Most had failed to give the matter much thought at this stage, though they were uneasy about control of the proposed new UK bank (the so-called fifth force alongside Nat West, Barclays, Lloyds and Midland) being removed to London. They were also wary of following the Labour Party and the SNP, both of whom had cried "wolf" as soon as the merger terms were announced. But Fletcher's most important move was to approach the newly installed Trade Secretary John Biffen who had been a regular attender of the Scottish Conservative backbench meetings during the run-up to devolution and had a good idea of the importance of keeping the Scots sweet. Biffen turned out to be sympathetic. This was important since as Trade Secretary he had the ultimate responsibility for deciding whether to refer the Standard Chartered bid to the Monopolies Commission.

The difficulty for Fletcher was how to draw up a convincing case for referral. It was to say the least unusual for the Monopolies Commission to be called in when there was no danger of a monopoly being created and when both parties endorsed the terms of the deal. The line he took, with the support of George Younger, was to argue in terms of public interest. An independent Scottish bank was an important asset to the Scottish economy and to remove control south could jeopardise jobs and new businesses north of the Border. Whether that line would have stood up to examination is uncertain. There were question marks over the Royal Bank's ability to compete in the big league and prospects for future growth were bleak unless the bank hitched up with a bigger partner. There may have been a case for changing the terms of the marriage contract but the case for blocking it altogether seemed too charged with Scottish emotion.

That impression grew stronger when The Scotsman revealed that a small group of financiers, including De Vink and Noble, had suggested a completely different deal to the Royal Bank and, indeed, to the Bank of England. They proposed hiving off the Royal Bank's wholly owned subsidiary Williams and Glyns and selling it to Standard Chartered in return for a shareholding in Standard. The Royal, revitalised with Scottish blood, would then take the plunge overseas and everyone would live happily ever after. The Royal Bank board sat tight and said not one word, not even confirming that they had received such a proposal.

At the time it might have seemed the right thing to do. The Royal had been looking for a partner since October 1979 and had considered several banks. Standard Chartered was the perfect fit, according to Sir Michael Herries, because it allowed the Royal to plug into Standard's overseas network and allowed Standard to get into the UK where there was plenty of potential deposit money to mop up. Privately, he is said to have been baffled at what all the fuss in Scotland was about.

He soon found out. Soon after the merger talks between the Royal and Standard had been announced, a new suitor arrived on the scene. The suitor was big, very big, and came all the way from Hong Kong. The day after almost doubling Standard's original offer, a group of executives from the Hong Kong and Shanghai Banking Corporation stepped out of a Rolls Royce in St Andrew Square and completely upstaged Standard by giving specific assurances on Scottish autonomy if and when a merger should take place. They also neatly trumped Standard by promising that the Royal Bank would be the "flagship" of a new European operation.

The entry of the Hong Kong dragon and the subsequent matching of their offer by Standard Chartered ensured that both bids went to the Monopolies Commission. Though the Office of Fair Trading were uneasy about handling the bids because there was no clear monopoly, Biffen was able to argue that a referral was in the public interest. He also let it be known that he had taken into account the importance of Edinburgh as a financial centre and the importance of a strong Scottish banking system. Once again the market had not been allowed free play: two giant banks had not been obliged to slug it out in public and Mr Fletcher had succeeded in pushing for some recognition that there was such a thing as Scottish public interest.

The question to be settled by the Monopolies Commission was whether the drive for a City-based UK-managed fifth force in British banking - the offspring of the Royal's marriage with Standard Chartered - should overweigh the Scottish case for retaining and developing Edinburgh as a healthy alternative to London. The outcome of the battle for the Royal Bank was also seen as likely to affect the future of Scotland's other major bank, the Bank of Scotland, currently 35 per cent owned by Barclays Bank. Once the door was opened into Scotland it could only be a matter of time before more hungry predators came sniffing around for a chance to snap up the Bank of Scotland.

But how Scottish is the Royal Bank and was there any point in arguing in terms of Scottish public interest? The majority of Royal Bank shares are said to be held outside Scotland, indeed the two biggest shareholders are Lloyds (16 per cent) and the Kuwait Investment Office (around seven per cent). One of the headlines ran "Scotland's banking future up for auction." Well, yes, but was this not one more lament at the death of devolution and a refusal to admit that the wheels of control were in fact revolving in the

South. When Michael Sandberg, chairman of the Hong Kong bank flew to Edinburgh to meet the top executives of the Scottish financial institutions he found that many of them were attending meetings in London for the week.

For many Scots, the Royal Bank takeover bids raised some unpleasant questions. For the ordinary deposit holder it meant that the bank on the corner might suddenly change its name and its notes; for the businessman in Scotland it meant that the all-important informal contacts might be lost; for some of the members of the Royal Bank board it meant that issues they had argued for passionately in the past quietly took a back seat.

Peter Balfour, vice chairman of the Royal Bank, was also chairman of Scottish and Newcastle breweries and chairman of the Scottish Council which consistently complained about the stampede of decision makers to London from Scotland. Robin Duthie, the man who had delivered the "north of Watford" speech only months earlier had endorsed the deal with Standard. Nowhere was there any sign in the original deal announced in London that these two powerful men had extracted some copper-bottomed guarantees for Scottish autonomy or even seen it as necessary to do so.

The takeover battle also illustrated how difficult it was to organise a Scottish financial lobby to put forward a strong public case for autonomy; instead it was left to the "outs" like De Vink and Noble. The "ins" who were prominent in Scotland's commercial and semi-political life were often either on the Royal Bank board or knew them very well. Balfour, Duthie and Max Harper-Gow, all Royal board members held numerous other directorships; Sir Michael Herries, chairman, became chairman of Scottish Widows Fund and Life Assurance during the takeover battle. Many others felt there was a clear clash between personal friendship and professional instinct and so chose to remain silent. With one or two notable exceptions such as Lord Clydesmuir, the retiring governor of the Bank of Scotland, many felt that it was not worth speaking out for something as ill-defined and intangible as the Scottish public interest.

It was a response characteristic of two years of Conservative rule, two years marked by a sense of impotence as workers fought for higher severance pay rather than the preservation of their jobs.

In Conservative vocabulary that was the New Realism, the spirit of change required for revival. But hope for the future rests on a measure of control being retained north of the Border and this was recognised by the Conservatives when and where they practised their constructive interventionism. So, despite the anti-interventionist and one nation rhetoric, Scottish Office ministers were well aware of the need to fight Scotland's corner at Whitehall. Scotland continued to be marketed as a separate entity, even if the Scottish Development Agency was forced to relinquish some of its influence to the Civil Service. While it is true that the Conservatives allowed the recession to take its toll of companies north of the Border, they nevertheless selected carefully the issues over which to fight. When Ferranti was threatened, a political campaign was organised to secure its independence. The Monopolies Commission, the official body entrusted to watch over such matters, was ignored. And yet, during the Royal Bank takeover battle the Commission was used as an instrument temporarily to block two bids neither of which constituted a potential monopoly. The guardian of the public interest had suddenly become the guardian of the Scottish public interest. It was the supreme example of the triumph of politics over rhetoric. There was indeed more than an invisible hand at work in the Scottish economy at mid term.

REFERENCE

1. Ray Perman, Financial Times, November 9 1979